



University of Wisconsin  
Hospital and Clinics

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October 18, 2004

Governor Jim Doyle  
Room 115 East State Capitol  
Madison, WI 53702

#1326 received 10/18/04 (hand delivered) - csb  
Judy was expecting this and will review at briefing  
with RB to see how to proceed and asked that a  
cc be made for Randy - Orig to Judy

Per RB on 10/19 - he will call Lisa Maroney on this  
as Lisa had asked for a follow-up meeting based on  
this letter.

Per RB on 10/20 - he has already given cc's of letter  
to Fred and Eileen. JA at this time to give copies to  
Roger, Steve J, and Commissioner - Orig to Cindy to file: Unity

Dear Governor Doyle:

We had called your office to attempt to schedule an appointment to talk directly with you about the UW Medical Foundation's and UW Hospital and Clinics', through their jointly owned 501(c) (3) company, University Health Care, Inc., acquisition of Unity Health Plans Insurance Corporation ("Unity") as of December 31, 2004. We understand that some questions have been raised regarding this acquisition, and we wanted to make certain that you had the pertinent history, facts and rationale regarding the Unity and UW Health relationship. We certainly understand how busy schedules are, so we wanted to assure that you had this information as quickly as possible.

1. Today's Unity was established in November of 1994. This occurred when U-Care HMO, a University of Wisconsin HMO operated by Unity Health Care (UHC) and with 25,000 members, joined with HMO-Wisconsin, a rural HMO with 35,000 members, Blue Cross & Blue Shield United of Wisconsin ("BCBS"), and United Wisconsin Services ("UWS"), collectively, to form a joint venture;
2. BCBS and UWS desired to enter into this joint venture to establish a managed care operation in Southern Wisconsin utilizing the provider relationships U-Care and UHC already had established in the region;
3. Per the joint venture, a Governing Board was established giving the joint venturers operational and governing control over the joint venture, plus there was risk and profit sharing built into the joint venture. UWS paid a "purchase price" for U-Care defined as "100% of the statutory net worth of U-Care as of September 30, 1994...., plus \$500,000 attributable to good will" and, upon paying said purchase price, became the sole equity owner of the combined HMO (now Unity) stock. It should be noted that "statutory net worth" is an accounting term that is very different from "fair market value (FMV)";
4. A key aspect of the transaction, however, was UHC's indisputable contracted right to reacquire its interest in the U-Care (now Unity) business at the end of 5- and 10-year terms. An "exercise price" for that right was defined in the original agreement and in a September 30, 1999

amended and restated agreement. The latter agreement defines the exercise price as “(i) \$500,000 plus (ii) the proportionate share of the net worth of Unity attributable to the UHC Business minus (iii) \$650,000 minus the aggregate amount of Annual Performance Bonuses paid ....” “Net worth” for the exercise price was to be calculated in the same manner as “net worth” had been calculated in UWS’s original purchase price but the “exercise price” clause specifically stated that the exercise price “shall not include any amount attributable to good will”;

5. At the conclusion of the first five-year term, the terms and risk sharing aspects of the joint venture arrangement were renegotiated. The level of financial risk was reduced to the providers and the term of the joint venture was renewed through December 31, 2004. The reacquisition option of the parties which originally contributed was again renewed in 1999 as well as a BCBS/UWS right to similarly receive book value, plus repayment of certain loans made to joint venture parties, if the purchase option were exercised;
6. On or around December of 2000, Blue Cross & Blue Shield announced its intention to convert to a for-profit corporation and merge with UWS. This merger transaction was approved predicated on the requirement that certain public charitable value represented in the BCBS stock sale be returned to the public. The UW Medical School and the Medical College of Wisconsin were later identified as stewards and recipients for portions of these public funds. As a consequence of this merger, UWS, was renamed Cobalt and BCBS became a subsidiary corporation of Cobalt;
7. In June of 2003, WellPoint Health Networks, a for-profit company, announced that it would buy Cobalt Corp. for approximately \$906 million in cash and stock;
8. In October of 2003, WellPoint and Anthem, another for-profit company, announced their intention to merge;
9. In the last quarter of 2003, and prior to making any decision to reacquire Unity, Cobalt, BCBS, Unity, UHC, University of Wisconsin Hospital and Clinics (“UWHC”) and University of Wisconsin Medical Foundation (“UWMF”) collectively commenced many months of negotiations, lasting through May of 2004, to come to acceptable terms on provider payment and other transactional terms relative to the Unity business including at the end, asking for and receiving, WellPoint offers to buy out UHC’s repurchase rights;

10. Entering into these negotiations, UWHC and UWMF had absorbed multi-millions of dollars of loss in the prior two fiscal years in providing care to Unity HMO members, and it was anticipated that in FY 2004, UWHC would go on to lose close to \$10 million. By way of contrast during this same period of time, Cobalt reported substantial Unity profits;
11. The non-financial provider terms that WellPoint/Cobalt offered through the many exchanges of the parties, no longer allowed any independent medical management rights for UW Health partners. In addition, it was clear that functions such as pharmacy management would cease to be a local Unity function, and would revert to corporate WellPoint pharmacy programs using a national formulary and entailing little local control or influence. UWMF and UWHC believed that these changes would have represented meaningful interference with its physicians and clinics. WellPoint would not offer the UHC providers the right to direct any medical utilization management programs to manage overall provider costs. Finally, WellPoint/Cobalt did not offer to renew UHC's joint venture repurchase option, which was of significant value to UHC, both financially and strategically;
12. Consequently, and only after exhausting any prospect of achieving acceptable provider payment financial and non-financial terms with Unity/BCBS/Cobalt/WellPoint, did UWHC and UWMF, pursuant to its contractual right to do so, turn their full attention to analyzing the costs and benefits of reacquiring Unity;
13. As discussed above, the purchase option cost to reacquire Unity is contractually established at "statutory net worth" plus certain payments and pay-offs of loans. An independent valuation of Unity by established a FMV of \$47 million compared to the "all-in" contractual reacquisition costs of approximately \$30 million. This \$17 million of value difference was and is a material economic opportunity for UHC as the holder of the reacquisition options. Subsequent attempts to cause WellPoint to agree to compensate UHC for this value difference did not succeed;
14. In evaluating the true costs of funding the acquisition, it was noted that the \$30 million dollar cost of the acquisition would have been indirectly expended simply through UWHC and UWMF absorbing the losses arising from inadequate WellPoint provider payments over a subsequent five to eight year period.

15. Regardless of the economic benefits and the ability to stem yearly economic provider losses, the respective boards of UWMF and UWHC evaluated other considerations of ownership, including, but not limited to:
  - Allowing UWHC and UWMF to manage their patients through decisions made locally and not by out-of-state entities
  - Maximizing the UW Health goal of “patients first”
  - Improving revenue and reducing UWHC and UWMF losses arising from serving the Unity members
  - Avoiding the inherent mission and operating practice incompatibilities between for- and not-for-profit entities
  - Gaining control of premium setting and provider payments
  - Preserving future sale/merger/collaboration opportunities
  - Maintaining a favorable image of the Unity brand name and its strong association with UW Health
  - Potential for direct employer contracting relationships
  - Maintaining greater provider network control;
16. Consequently, given the fiduciary duty of the two Boards to not forgo such a value and control opportunity unless deemed prudent, and only after fully taking into consideration all the risks and benefits of ownership, including stringent financial comparisons between the last and best offer of Cobalt (on terms of both provider contracts and buyout of repurchase rights) versus the full value of UHC ownership, did both the UWHC and UWMF boards vote and approve the funding of UHC, allowing it to exercise its contractual rights to reacquire Unity;
17. As a result of this decision, the University of Wisconsin Hospital and Clinics Authority and the University of Wisconsin Medical Foundation, as two of three partial owners of UHC, agreed to jointly fund UHC to reacquire Unity though first acquiring the HMO-Wisconsin (now Community Health Services, LLC) (“CHS”) Unity repurchase rights as well as exercising UHC’s stand-alone repurchase right;
18. Given UWHC’s and UWMF’s agreement, the University of Wisconsin Medical School (“UWMS”) is not involved in the funding or ownership of Unity. It will receive no proceeds if and when Unity is ever sold by UHC. Neither the State of Wisconsin nor other public funds, or any of the awarded UW funds related to the BCBS’s conversion into a for-profit is involved in the transaction;
19. It is not known whether WellPoint in its acquisition of Cobalt, was made known of, or in its due diligence, properly discovered the existence of the contractual right by UHC and CHS to reacquire Unity. In any event,

UWHC and UWMF cannot now be responsible for whether in a for-profit transaction, Cobalt set forth and WellPoint in its due diligence, became aware of, the ability of UHC and CHS to reacquire Unity. Since the abandonment of provider term negotiations in May, UW parties have proceeded in good faith on the repurchase transaction with Cobalt and WellPoint;

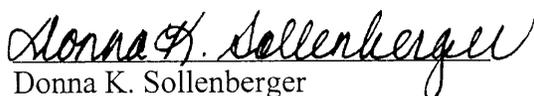
20. Under these facts and circumstances, we believe that there would be little justification for UWHC and UWMF not to have exercised its options nor to now abandon the transaction. Given the dollar value of the repurchase right, exercising abandonment of the transaction now could also leave UWHC and UWMF open to criticism of facilitating private inurement through improper transfer of 501(c)(3) charitable, or public Authority assets.

As you can see, we have thought through this acquisition very carefully and exercised these options only after it was clear that we could not reach reasonable contractual terms with WellPoint regarding Unity. We have been proceeding in what can be described as an amicable transition; thus we were surprised when we learned that as UW Health was working with WellPoint representatives on the acquisition that some of the same individuals and others from WellPoint were contacting you and other governmental and university officials in an attempt to question, at best, or undo the deal.

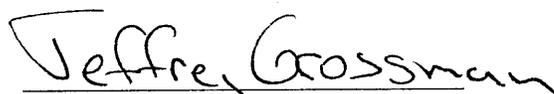
We firmly believe that this acquisition is in the best interests of the people of Wisconsin and of those individuals who have selected Unity as their health plan. To have decisions made locally and to attempt to reduce the substantial losses UW Health has incurred made this decision critical.

Please feel free to contact either one of us if you have any questions.

Sincerely yours,



Donna K. Sollenberger  
President & CEO  
University of Wisconsin Hospitals  
and Clinics Authority



Jeffery E. Grossman, M.D.  
President & CEO  
University of Wisconsin  
Medical Foundation

DKS/JEG/a

cc: Marc Marotta Esq., Secretary of Administration  
Jorge Gomez Esq., Commissioner of Insurance